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Institutional Ownership, Free Cash Flow, Profitability, and Earnings Management

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Abstract

Purpose: This study examines the effects of institutional ownership, free cash flow, and profitability on accrual-based earnings management in Indonesian food and beverage companies during 2021–2024.

Research Methodology: Financial reports from 53 purposively selected companies yielded 212 firm-year observations. After excluding 19 outliers, 193 observations were analyzed using multiple linear regression in SPSS 26, with 192 remaining after lag transformation. Earnings management was measured using signed discretionary accruals from the Modified Jones Model, while autocorrelation was addressed through the Cochrane–Orcutt transformation.

Results: Institutional ownership showed a positive but insignificant association (B = 0.148; p = 0.201). Free cash flow was negatively associated with discretionary accruals (B = −1.141; p < 0.001), whereas profitability showed a positive association (B = 1.300; p = 0.003). The overall model was significant (adjusted $R^2 = 0.246$).

Conclusions: Institutional ownership proportions alone did not indicate effective monitoring. Higher free cash flow was associated with lower signed discretionary accruals, while greater profitability corresponded to increased reporting discretion, requiring consideration of cash flow and governance evidence.

Limitations: The study covers one sector and four years, uses secondary data and signed accrual measures, excludes control variables, and lacks sensitivity testing for outlier removal, limiting causal interpretation.

Contributions: This study extends contemporary agency theory perspectives by showing that institutional ownership does not necessarily ensure effective monitoring, while cash flow and profitability exhibit contrasting relationships with earnings management, emphasizing financial conditions in managerial reporting discretion.

Keywords: *Earnings Management, Free Cash Flow, Institutional Ownership, Net Profit Margin, Profitability*

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1. Introduction

Financial statements constitute management's accountability to shareholders and stakeholders regarding company performance over a reporting period. The information presented must be relevant, reliable, understandable, and neutral so that it can serve as a basis for economic decisions. Changes in financial statement presentation standards, including the implementation of PSAK 201, which effectively replaced PSAK 1 on January 1, 2024, have reinforced the requirement that financial statements not mislead users. For public companies, the obligation to submit audited financial statements to the Indonesia Stock Exchange makes the quality of earnings information an important component of capital market credibility. Investors, creditors, regulators, and management use earnings to assess prospects, risks, and the company's capacity to generate future cash flows (Arieska, Nurmala, & Dewi, 2023).

The 2021–2024 period marked a transition from the shock of the pandemic toward recovery. Food and beverage companies faced changing consumption patterns, distribution disruptions, rising raw material prices, fluctuations in purchasing power, and pressure to maintain production continuity. These pressures may increase management's incentives to present stable performance, increase earnings, or defer expense recognition. At the same time, the food and beverage sector has relatively recurring demand and plays an important role in the national manufacturing chain, making company financial statements a concern for investors. The case of PT Tiga Pilar Sejahtera Food Tbk (AISA) shows that a substantial difference between reported earnings and the economic condition subsequently revealed can reduce market confidence and trigger trading sanctions. This case confirms that examining factors associated with earnings management in this sector remains relevant.

This study uses agency theory to explain why the separation of ownership and management can generate conflicts of interest. Shareholders, as principals, expect an increase in firm value, whereas managers, as agents, possess more information and may pursue compensation, job security, or reputation. Information asymmetry expands managerial discretion in selecting accounting policies. Monitoring mechanisms and internal financial conditions then become important determinants that can weaken or strengthen opportunities for opportunistic behavior (Jensen, & Meckling, 1976; Fama, & Jensen, 1983). Institutional ownership is expected to improve monitoring because institutions possess analytical resources, access to information, and relatively substantial economic interests. However, the ownership percentage is not always synonymous with active involvement. Institutions may be passive shareholders, have business relationships with management, or focus more on short-term returns. Previous findings are inconsistent: some studies report a negative effect, some find no effect, and others find that institutional investor pressure may encourage earnings management practices (Hardirmaningrum, Pramono, Hariyanto, & Wibowo, 2021; Gunawan, & Ruslim, 2025; Nuryana, & Murdianinsih, 2025). This uncertainty provides an opportunity to reexamine the relationship in the food and beverage sector. Argument of agency theory Juni, Putra, Merawati, and Tandio (2023), whereas the positive and insignificant findings above are treated as competing explanations that the data may support or reject.

Free cash flow is the cash remaining after a company finances its operating needs and capital expenditures. Two competing perspectives link it to earnings management. From the perspective of the agency cost of free cash flow, abundant free cash expands managerial discretion to invest in less productive projects or use company resources for personal interests, which may motivate managers to present favorable earnings to conceal inefficient use of cash (Jensen, 1986; Oktavia, & Raflis, 2025; Ningtyas, & Achyani, 2025). From the financing-constraint perspective, strong cash flow reduces external financing pressure and the need to embellish earnings, so a negative association is expected when cash reflects genuine operating performance (Hardirmaningrum et al., 2021; Mayangsari, 2025). Empirical evidence from Indonesia has accordingly shown mixed directions. Profitability reflects a company's ability to generate earnings from sales or managed resources. Net Profit Margin (NPM) is used because it relates after-tax net income to sales and therefore captures overall operating efficiency, pricing, cost control, financing, and tax (Kasmir, 2019). High profitability may signal strong performance, but it can also create pressure to maintain an earnings trend. Conversely, low profitability may encourage managers to conceal weak performance. Previous studies have reported

positive, negative, and insignificant results (Sari, Hanun, Hanif, & Rahayu, 2024; Gusmiarni, 2024; Yoewono, & Roziq, 2024; Valeska, & Mulyana, 2023).

The Goodwood literature shows that the relationships among governance, financial conditions, and reporting quality are contextual. Mokrani and Alami (2021) demonstrate that governance mechanisms do not always operate uniformly and that institutional ownership may be positively associated with earnings management in certain contexts. Choirunnisa (2022) emphasizes the need to distinguish accrual-based and real earnings management when assessing tax aggressiveness. Ado and Tanko (2024) likewise show that real earnings management is associated with tax planning in manufacturing. Verrel and Setyawan (2025) find that financial distress increases earnings management, whereas cash holding reduces it. Ishak (2024) positions earnings quality as a link between earnings management and firm value.

Based on these inconsistencies, this study examines the effects of institutional ownership, free cash flow, and profitability on earnings management practices among food and beverage companies listed on the Indonesia Stock Exchange during 2021–2024. The contribution of this study is to provide evidence from the post-pandemic recovery period, use the Modified Jones Model after outlier screening and autocorrelation treatment, and connect ownership, internal cash, and profitability indicators in a single model. Because earnings management is measured by signed discretionary accruals, the coefficients are interpreted as shifts toward income-increasing or income-decreasing accruals rather than as changes in the magnitude of earnings management, and the model is read as a test of association without control variables. The results are expected to help management strengthen reporting quality, help investors assess earnings more critically, and enrich financial accounting research in Indonesia.

2. Literature Review and Hypotheses Development

2.1 Agency Theory and Earnings Management

Agency theory explains the contract between a principal and an agent when resource ownership is separated from resource management. Shareholders delegate decision-making to managers with the expectation that managers will maximize firm value. Because objectives, risk tolerance, and access to information may differ, agency costs arise and monitoring mechanisms are needed (Jensen & Meckling, 1976). Fama and Jensen (1983) add that separating decision-making and control can reduce the risk of abuse when monitoring functions are designed effectively. In financial reporting, agency conflicts appear when managers choose estimation policies, revenue recognition, provisions, or operating decisions that alter reported earnings. Earnings management does not always constitute a violation, because some discretion may be used to communicate information about future performance. However, when discretion is used to meet compensation targets, avoid covenant violations, or influence market perceptions, earnings quality and the reliability of financial statements may decline (Dechow et al., 1995, 1996).

The Modified Jones Model measures earnings management through discretionary accruals. Larger absolute discretionary accruals indicate a higher degree of accrual intervention, whereas a positive or negative sign indicates a tendency to increase or decrease earnings. This measure captures one form of earnings management and is not intended to constitute sole evidence that a company has committed fraud. Accordingly, interpretation of the results should consider industry characteristics, cash flow, profitability, and monitoring mechanisms. Discretionary accruals indicate accounting discretion rather than proof of misconduct (Dechow et al., 1995). Accrual and real activities measures need not identify the same decisions: Buanaputra (2021) examines their interaction, while Fitrasari (2023) analyzes board oversight across both forms. A modified M-score addresses a different detection question (Narsa et al., 2023). Consequently, the estimates below are interpreted only as associations with the accrual proxy.

2.2 Institutional Ownership and Earnings Management

Institutional ownership is the proportion of shares held by banks, insurance companies, pension funds, investment companies, the government, or other institutions. Institutions are assumed to have greater

incentives and capabilities to obtain information, evaluate managerial policies, and constrain opportunistic behavior. Such monitoring should reduce agency conflicts and narrow management's opportunity to manipulate earnings (Hardirmaningrum, Pramono, Hariyanto, & Wibowo, 2021). However, monitoring depends on the quality of engagement, ownership concentration, investment horizon, and institutional independence. Cross-market evidence suggests that monitoring varies with governance and market conditions (Al-Haddad, & Whittington, 2019; Diri, Lambrinoudakis, & Alhadab, 2020). Mokrani and Alami (2021) even find that institutional investor ownership may be positively associated with earnings management in certain market contexts. These findings mean that a negative relationship is not automatic. H_1 is nevertheless directed toward a negative relationship because the monitoring argument of agency theory is the primary theoretical prediction for institutional ownership (Hardirmaningrum et al., 2021; Juni, Putra, Merawati, & Tandio, 2023). The positive or insignificant results reported elsewhere reflect the competing passive-ownership, short-term-return, and investor-pressure arguments; this study therefore tests the monitoring prediction against these competing explanations rather than assuming either of them.

Governance evidence reinforces the distinction between shareholding and active oversight. Al-Haddad and Whittington (2019) examine how governance mechanisms relate to accrual and real earnings management, while Diri et al. (2020) show that market concentration can shape that relationship. Valeska and Mulyana (2023) report a negative institutional ownership association in Indonesian consumer companies, whereas Umaryadi, Susanto, Piyani, and Idiah (2026) report a positive association in another consumer goods sample. The different signs make the insignificant coefficient in this study substantively informative rather than a reason to assume monitoring has no value.

H_1: Institutional ownership has a negative effect on earnings management practices

2.3 Free Cash Flow and Earnings Management

Free cash flow represents cash available after operating cash flow is reduced by capital expenditures and then normalized by total assets. This cash can be used to pay debt, dividends, investments, or other strategic needs. Jensen (1986) explains that excess cash can create agency costs because managers have room to finance value-destroying projects or delay distributions to shareholders. When monitoring is weak, management may use accounting discretion to conceal inefficient use of cash. Conversely, free cash flow can also signal operating health and reduce a company's need for external financing. Companies capable of generating cash can finance operations and investments without having to pursue earnings targets to reassure creditors or investors. Verrel and Setyawan (2025) find that cash holding reduces earnings management, while Hardirmaningrum, Pramono, Hariyanto, and Wibowo (2021) also report a negative relationship between free cash flow and earnings management. Because earlier findings are not uniform, two competing predictions exist: a positive coefficient under the agency cost of free cash flow (Jensen, 1986; Oktavia, & Raflis, 2025; Ningtyas, & Achyani, 2025) and a negative coefficient under the financing-constraint and operating-health perspective. H_2 is formulated on the agency cost perspective because agency theory is the theoretical foundation of this study, and the empirical test determines which of the two mechanisms is better supported. A significant negative coefficient would therefore not contradict the theoretical framework; it would indicate that the competing mechanism dominates in the sample.

Recent studies operationalize cash resources and reporting discretion in different sectors. Santoso (2023) considers governance as a moderator of the free cash flow relationship. Nurfaidilla and Susanti (2024) study manufacturing firms, Ramadhanty and Aprilia (2025) examine consumer non-cyclicals, and Mardianto (2025) separate accrual from real earnings management. Toumeh, Yahya, and Amran (2023) focus specifically on surplus cash and independent audit committees. These designs help explain why an agency cost prediction for abundant cash need not determine the sign of the coefficient in every sample.

H_2: Free cash flow has a positive effect on earnings management practices

2.4 Profitability and Earnings Management

Profitability is a company's ability to generate earnings and reflects management effectiveness in managing sales, costs, assets, and capital. NPM is used in this study because it shows the proportion of after-tax net income to sales. High profitability can increase investor confidence, but an already high earnings target creates pressure to preserve reputation and the continuity of the trend. Managers may be encouraged to engage in income smoothing or increase earnings when actual performance falls short of expectations. An opposing perspective holds that genuinely profitable companies have stronger cash flows and operating capacity and therefore do not need manipulation. These different mechanisms mean that the direction of the relationship between profitability and earnings management depends on contractual pressure, incentive structures, and governance. Positive profitability associations have been reported by Yoewono and Roziq (2024); Valeska and Mulyana (2023), whereas some studies find a negative or insignificant direction. Based on the pressure to maintain high performance, the research hypothesis is directed toward a positive relationship.

Evidence from related Indonesian settings also varies by performance proxy and governance condition. Sari et al. (2024) examine managerial ownership as a moderator in food and beverage companies; Gusmiarni (2024) studies profitability alongside capital structure and stock returns; and Yoewono and Roziq (2024) examine operating cash flow with institutional ownership as a moderator. Other sector studies consider audit quality and board oversight (Trisakti, 2024). This literature supports interpreting net profit margin together with the firm's cash conversion and the incentives surrounding the reported result.

H_3: Profitability has a positive effect on earnings management practices

2.5 Simultaneous Effects

The three variables represent complementary mechanisms. Institutional ownership reflects external monitoring, free cash flow reflects resource flexibility and potential agency costs, and profitability reflects performance pressure. Active institutional investors may constrain opportunistic actions, but weak monitoring leaves cash and earnings pressure as sources of discretion. Goodwood research also emphasizes the relationships among earnings quality, monitoring, and firm value (Ishak, 2024; Mokrani, & Alami, 2021).

H_4: Institutional ownership, free cash flow, and profitability simultaneously affect earnings management practice

3. Research Methodology

3.1 Design, Population, and Sample Screening

This study uses an explanatory quantitative approach with secondary data. The unit of analysis is food and beverage companies listed on the Indonesia Stock Exchange during 2021–2024. The population consists of 103 companies. The sample was selected through purposive sampling using the following criteria: the company was listed and active during the observation period; published financial statements consecutively; and had institutional ownership information identifiable in its annual reports. A total of 53 companies met the criteria, resulting in 212 firm-year observations.

Financial statements and annual reports were obtained from the official Indonesia Stock Exchange website. Data were collected through documentation, after which information on net income, operating cash flow, capital expenditures, total assets, sales, and shareholder composition was tabulated in a worksheet. This procedure enabled consistent calculation of ratios across companies and periods. The residuals of the initial model failed the Kolmogorov–Smirnov normality test ($N = 212$; significance < 0.001), so the data were screened for extreme values and 19 observations were eliminated, leaving 193 observations for the final analysis. The eliminated observations belong to ten companies (BEEF, BTEK, BWPT, COCO, DPUM, FOOD, MLBI, TAPG, UNSP, and WMUU); 17 of the 19 had a net profit margin below −0.25 or above 0.30, and BTEK lost all four firm-years.

Purposive sampling selected companies with continuous reports and identifiable institutional shareholding, so the findings apply to the screened sample rather than to every listed issuer (Sugiyono, 2023). The exclusion of 19 extreme company-years is reported separately in Tables 2 and 3 to make the change in the analytic sample transparent. The statistical criterion used to flag the extreme values (for example, z-scores, Mahalanobis distance, or Cook distance) was not recorded in the source analysis, and the models were not re-estimated with all 212 observations. Because the excluded firm-years are concentrated at the extremes of profitability, cash flow, and ownership, the estimates should be read as applying to non-extreme firm-years and may be affected by selection bias.

3.2 Variable Measurement

Earnings management (Y) was measured using discretionary accruals from the Modified Jones Model (Dechow, Sloan, & Sweeney, 1996). The first stage calculated total accruals (TAC) as net income minus operating cash flow. The second stage estimated accrual coefficients using cross-sectional regression. The third stage calculated nondiscretionary accruals using changes in revenue adjusted for changes in receivables and fixed assets. The fourth stage obtained discretionary accruals by subtracting nondiscretionary accruals from total accruals normalized by prior-year total assets. Earnings management was analyzed using the signed discretionary accrual values (DTAC) contained in the source dataset.

A recent application in another Indonesian sector likewise uses the Modified Jones Model for discretionary accruals (Zahra & Aminah, 2025). That article describes expected findings rather than a completed comparison of coefficient estimates, so it is cited here for its measurement design only. The dependent variable in the present regression follows the signed values in the analyzed dataset; a coefficient therefore describes movement in signed discretionary accruals and cannot, by itself, establish a change in their absolute magnitude. Only three of the 212 DTAC values are negative (−0.0646 to −0.0279), and all three remain in the 193-observation sample, so DTAC is positive for 190 of the 193 analyzed observations; the coefficients thus mainly describe movement among income-increasing accruals, and absolute discretionary accruals were not estimated separately.

Institutional ownership (X_1) was measured by dividing the number of shares held by institutions by the number of shares outstanding. Free cash flow (X_2) was calculated as operating cash flow minus capital expenditures divided by total assets. Profitability (X_3) was proxied by NPM, namely after-tax net income divided by sales (Kasmir, 2019). The operational definitions are summarized in Table 1, and the symbols Y, X_1, X_2, and X_3 in Table 1 are the same variables entered in the regression equation.

3.3 Statistical Analysis

The analysis was conducted using IBM SPSS Statistics 26. Descriptive statistics were used to examine the minimum, maximum, mean, and standard deviation. The assumption tests included Kolmogorov–Smirnov residual normality, multicollinearity through tolerance and VIF, heteroskedasticity through Spearman correlation, and autocorrelation through Durbin–Watson. The initial data did not meet normality and indicated autocorrelation. After outliers were removed, the residuals were normally distributed. Autocorrelation was addressed using the Cochrane–Orcutt procedure (Ghozali, 2021), in which each variable is transformed using its lagged value (the transformed variables appear as LAGX1–LAGX3 in the SPSS output); the autocorrelation coefficient implied by the initial Durbin–Watson statistic is approximately 0.40 (1 − 1.191/2). The resulting DW value was within the acceptance range. The degrees of freedom of the final model (3 and 188; Table 6) imply 192 observations, that is, one observation was lost, which indicates that the lag was applied to the pooled firm-year series rather than within each company; the standard errors in Table 5 are those of the transformed model.

The regression model, with the variables defined in Table 1, was formulated in Formula 1 as follows: The regression and classical-assumption procedures follow standard multivariate and econometric guidance (Ghozali, 2021). The reported post-transformation fit statistics must be read with the stated sample size and degrees of freedom; Table 3 reports the descriptive statistics for both the 212 initial

and the 193 final observations, whereas Tables 4 to 6 refer to the 193-observation analytical sample (192 observations after the lag transformation).

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e \quad (1)$$

Note: Y = earnings management, measured as signed discretionary accruals (DTAC); α = constant; β_1–β_3 = regression coefficients; X_1 = institutional ownership (IO); X_2 = free cash flow (FCF); X_3 = profitability measured by net profit margin (NPM); e = error.

Table 1 summarizes the four variables as they enter the equation above (Y, X_1, X_2, and X_3), their operational meanings, and the calculations applied consistently to the company-year data.

Table 1. Operational definition of variables

Variables	Operational Definition	Measurement
Earnings management (Y, DTAC)	Signed discretionary accruals from the Modified Jones Model	DTAC = TAC/TA_{t-1} − NDTAC
Institutional ownership (X_1, IO)	Proportion of shares held by institutions	Institutional shares / shares outstanding
Free cash flow (X_2, FCF)	Operating cash after capital expenditures, normalized by assets	(CFO − CapEx) / total assets
Profitability (X_3, NPM)	Ability to generate net income from sales	After-tax net income / sales

4. Results and Discussions

4.1 Sample Screening and Descriptive Statistics

The screening process began with 103 food and beverage companies listed on the Indonesia Stock Exchange. Forty-four companies did not publish reports consecutively, and six companies lacked the required institutional ownership data. Thus, 53 companies met the criteria. Because the study period covered four years, the initial number of observations was 212. Outlier screening removed 19 observations, leaving 193 observations in the final model. Table 2 shows how the population was screened into 53 eligible companies and how the final number of observations was obtained.

Table 2. Sample screening and selection procedure

Screening Stage	Number
Population of food and beverage companies listed on the Indonesia Stock Exchange	103
Did not publish consecutive financial statements	(44)
No institutional ownership data	(6)
Sample companies	53
Initial observations (53 × 4 years)	212
Eliminated outliers	(19)
Final observations	193

Table 3 reports the distribution of each variable in the 212 initial observations and, for comparison, in the 193 observations retained for the regression after the outlier exclusions.

Table 3. Descriptive statistics analysis results

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Institutional ownership (X_1) – initial	212	0.0587	0.9357	0.661353	0.1814426
Free cash flow (X_2) – initial	212	−0.4953	0.4768	0.035504	0.1165103
Profitability/NPM (X_3) – initial	212	−2.3950	0.7249	0.040237	0.2628886
Earnings management/DA (Y) – initial	212	−0.0646	2.3228	0.430301	0.2934506

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Institutional ownership (X_1) – final	193	0.2378	0.9357	0.665003	0.1761677
Free cash flow (X_2) – final	193	−0.4953	0.3471	0.034955	0.1131859
Profitability/NPM (X_3) – final	193	−0.2627	0.2969	0.075650	0.0987249
Earnings management/DA (Y) – final	193	−0.0646	2.3228	0.427244	0.2995598
Note: Initial sample N = 212; final sample N = 193.					

Institutional ownership had a mean of 0.661353, or approximately 66.14%, with a range of 5.87% to 93.57%. This mean indicates that institutional ownership is common in the sample, although variation across companies remains substantial. Free cash flow had a mean of 0.035504 and a standard deviation of 0.1165103. The minimum value of −0.4953 occurred when operating cash was insufficient to cover capital expenditures, whereas the maximum value of 0.4768 indicates companies with relatively substantial internal cash capacity. A standard deviation larger than the mean indicates heterogeneity in cash flow across companies.

Profitability, proxied by NPM, had a mean of 0.040237 and a standard deviation of 0.2628886. The minimum value of −2.3950 indicates a company experiencing a large loss relative to sales, whereas the maximum value of 0.7249 indicates a high net margin. Earnings management had a mean of 0.430301, a minimum of −0.0646, and a maximum of 2.3228. This range indicates differences in discretionary accrual intensity across the observed sector. After the 19 extreme observations were removed (N = 193), net profit margin ranged from −0.2627 to 0.2969 (mean 0.075650), the maximum free cash flow fell to 0.3471, and the mean of discretionary accruals changed only slightly (0.427244 compared with 0.430301), so the exclusion mainly trimmed the tails of profitability and cash flow.

4.2 Assumption Tests and Regression Model

Table 4 brings together the diagnostic tests before and after the adjustments to the estimation sample and residuals.

Table 4. Summary of classical assumption test results

Test	Main Result	Decision
Initial normality	K-S = 0.105; p < 0.001 (N = 212)	Not normal
Normality after outliers	K-S = 0.062; p = 0.068 (N = 193)	Normal
Multicollinearity	Tolerance 0.800–0.993; VIF 1.007–1.250	No problem
Heteroskedasticity	Sig. residual X1 = 0.407; X2 = 0.885; X3 = 0.643	Not detected
Initial autocorrelation	DW = 1.191; du = 1.7960	Present
Autocorrelation after Cochrane–Orcutt	DW = 1.979; 1.7960 < DW < 2.204	Absent
Note: Tests after the outlier exclusion use N = 193; the Cochrane–Orcutt model uses 192 observations after lagging.		

Following the diagnostic sequence (Ghozali, 2021), the Kolmogorov–Smirnov test indicated that the initial residuals were not normally distributed. After 19 outliers were eliminated, the significance value became 0.068, so normality was not rejected at the 5% level. All tolerance values were above 0.10 and VIF values were well below 10. The Spearman test showed residual significance values above 0.05. Autocorrelation observed in the initial model was addressed using Cochrane–Orcutt; the DW value of 1.979 was between du = 1.7960 and 4 − du = 2.204. Thus, the final model met the diagnostics used before hypothesis testing.

4.3 Hypotheses Testing

Table 5 presents the partial regression coefficients, significance tests, and decisions for the three directional hypotheses.

Table 5. Multiple linear regression analysis results (t-Test / Partial)

Variables	B	Std. Error	Beta	t	Sig.	Decision
Constant	−0.314	0.389	—	−0.808	0.420	—
Institutional Ownership	0.148	0.115	0.081	1.284	0.201	H_1 rejected
Free Cash Flow	−1.141	0.144	−0.557	−7.948	<0.001	H_2 rejected
Profitability/NPM	1.300	0.433	0.211	3.002	0.003	H_3 accepted
Note: N = 192 after lagging (df = 188); the coefficients are those of the lagged variables LAGX1–LAGX3 and are interpreted for signed DTAC.						

The earnings management regression equation is presented in Formula 2 as follows:

$$\text{Earnings Management} = -0.314 + 0.148\,IO - 1.141\,FCF + 1.300\,NPM + e \quad (2)$$

The institutional ownership coefficient was positive but insignificant. The free cash flow coefficient was negative and significant, indicating that higher FCF was associated with a shift toward lower (less income-increasing) signed discretionary accruals. The NPM coefficient was positive and significant, indicating that higher profitability was associated with a shift toward more income-increasing discretionary accruals. Because DTAC is signed, these coefficients describe the direction of the accrual shift; since 190 of the 193 retained values are positive they also bear on the intensity of accrual-based earnings management, but they are not a direct test of absolute magnitude.

Table 6. Regression model summary and F-test results (simultaneous)

Model Statistic	Value
R	0.508
R^2	0.258
Adjusted R^2	0.246
Standard error of estimate	0.13673
F statistic	21.783
df	3 and 188
F-test significance	<0.001
Durbin–Watson	1.979
Note: N = 192 after the lag transformation (df = 3 and 188).	

Table 6 presents the joint F-test and model fit statistics used to evaluate the simultaneous hypothesis. The F-test produced a value of 21.783 with significance below 0.001. This means that institutional ownership, free cash flow, and profitability simultaneously affected earnings management. An adjusted R^2 of 0.246 indicates that 24.6% of the variation in earnings management can be explained by the three variables, whereas the remaining 75.4% derives from factors not included in the model.

4.4 Institutional Ownership and Earnings Management

The results show that institutional ownership had a positive but insignificant effect on earnings management, proxied by signed discretionary accruals (B = 0.148; p = 0.201). Therefore, H_1, which predicted a negative effect, was rejected; the mixed governance results of Valeska and Mulyana (2023); Umaryadi, Susanto, Piyani, and Idiah (2026) provide useful context. The size of the institutional shareholding proportion alone was insufficient to explain changes in discretionary accruals among food and beverage companies during 2021–2024. This finding indicates that institutional ownership does not automatically function as effective monitoring. Institutional investors may have substantial economic interests, but monitoring depends on the quality of analysis, access to information, independence, and willingness to exercise voting rights. Institutions oriented toward short-term returns may choose to sell shares rather than participate in improving reporting processes. In a concentrated ownership structure, institutions may also have business relationships or aligned interests with controlling shareholders, limiting the effectiveness of monitoring.

This result is consistent with Gunawan and Ruslim (2025), who found no significant effect of institutional ownership. International evidence also shows that monitoring effectiveness varies by market context (Al-Haddad, & Whittington, 2019; Diri, Lambrinoudakis, & Alhadab, 2020). Institutional ownership may even be positively associated with earnings management, whereas a study of consumer goods companies finds a selective moderating role rather than a consistent direct effect (Verrel, & Setyawan, 2025; Mokrani, & Alami, 2021). The implication is that investors should not assess institutional ownership solely by its percentage. Investors should examine institutional attendance at general meetings of shareholders, disclosure quality, board composition, and responses to audit issues. For companies, governance improvements need to convert ownership into monitorable oversight through related-party transaction policies, audit committees, and information disclosure.

4.5 Free Cash Flow and Earnings Management

Free cash flow had a negative and significant effect on earnings management (B = −1.141; p < 0.001). This result rejects H_2, which predicted a positive direction, and is consistent with the negative free cash flow relationship reported by (Ramadhanty & Aprilia, 2025). Economically, companies with higher free cash flow tend to have lower discretionary accruals; because DTAC is signed, the negative coefficient indicates a shift toward less income-increasing accruals rather than a proven reduction in absolute magnitude. Adequate internal cash can reduce dependence on external financing and lessen pressure to present particular earnings to creditors or investors. This finding supports the financing-constraint perspective rather than the agency cost prediction underlying H_2, so the rejection of H_2 reflects the dominance of a competing mechanism rather than a conceptual conflict in the framework, and it adds nuance to the agency cost of free cash flow. Free cash may expand managerial discretion, but in this sample it appears to function more strongly as an indicator of operating capacity and financial flexibility. Companies able to generate cash after financing operations and investments have resources to sustain activities without changing reported earnings. Genuine cash performance also makes the difference between earnings and cash flow easier to evaluate, reducing the effectiveness of accrual manipulation.

The results are consistent with Hardirmaningrum, Pramono, Hariyanto, and Wibowo (2021); Verrel and Setyawan (2025), who find that liquidity or cash holding reduces incentives for earnings management. The results differ from Mardianto (2025), who report a positive relationship for accrual earnings management. These differences may arise from different FCF definitions, sectors, periods, and approaches to handling outliers. In the food and beverage sector, capital expenditures and working capital are critical to production continuity. Therefore, positive FCF may indicate that company operations generate sufficient cash to support real activities rather than merely accrual-based earnings. The practical implication is that management should allocate free cash to productive investment, liability payments, and transparent distributions. Investors should compare net income with operating cash flow and capital expenditures before drawing conclusions about performance quality. Auditors and audit committees can use earnings–cash reconciliations to focus testing on companies with high earnings but weak FCF.

4.6 Profitability and Earnings Management

Profitability had a positive and significant effect on earnings management (B = 1.300; p = 0.003). H_3 was accepted, although other samples report different profitability results (Gusmiarni, 2024; Umaryadi et al., 2026). The positive coefficient indicates that an increase in NPM was followed by a shift toward more income-increasing signed discretionary accruals, not necessarily by a larger absolute magnitude of earnings management. This finding supports the argument that high earnings can create pressure to maintain a performance image, meet investor expectations, and preserve performance-based compensation. High profitability does not always mean high earnings quality. Once a company has established a growth reputation, even a small decline may be perceived negatively. Managers may use accounting estimates, the timing of revenue recognition, or provisions to maintain earnings continuity. In the food and beverage sector, relatively stable demand and investor attention to margins may strengthen the incentive to preserve NPM. This finding does not state that every profitable company manipulates earnings; it indicates that profitability is a condition associated with reporting discretion.

This result is consistent with the positive profitability association reported by Yoewono and Roziq (2024); Valeska and Mulyana (2023). International evidence also shows that financial pressure and performance characteristics can affect earnings management (Agustia et al., 2020; Aljughaiman et al., 2023). Conversely, some studies find a negative direction because strong-performing companies do not need earnings engineering. These differences confirm the need to consider profitability together with target pressure, audit quality, financial distress, and governance. Consistent with the sector comparison by Gusmiarni (2024), for investors, NPM should be interpreted together with cash flow, changes in receivables, and discretionary accruals. For management, margin improvements should arise from verifiable operating efficiency and cost control rather than estimates that inflate earnings. Disclosure of accounting policies, assumption sensitivities, and cash flow reconciliations can strengthen market confidence.

4.7 Simultaneous Effects and Model Explanatory Power

The F-test shows that the three variables simultaneously have a significant effect on earnings management ($F = 21.783$; $p < 0.001$). An adjusted R^2 of 0.246 indicates that institutional monitoring, internal cash, and profitability jointly provide important information, although they do not explain all variation in earnings management. This result is consistent with agency theory because reporting practices arise from interactions among monitoring mechanisms, resource availability, and performance pressure. The explanatory power of 24.6% also confirms that earnings management is a multidimensional phenomenon. Other factors, such as leverage, company size, audit quality, financial distress, audit committees, managerial ownership, sales growth, and business strategy, may play a role. Verrel and Setyawan (2025) shows that financial conditions and internal controls should be considered together. Research on report integrity also places auditor reputation, company size, and audit delay in an important context (Ramadhanil, Ridwansyah, & Rusmianto, 2026). The policy implication is the need for integrated monitoring. Companies cannot simply increase the percentage of institutional ownership without improving monitoring effectiveness; increase earnings without ensuring that cash flows and accounting policies are traceable; or hold cash without transparent allocation and reporting mechanisms. Investors and regulators can use this combination of indicators as an initial signal for assessing earnings quality risk.

5. Conclusions

5.1 Conclusion

This study analyzed the effects of institutional ownership, free cash flow, and profitability on earnings management practices among 53 food and beverage companies listed on the Indonesia Stock Exchange during 2021–2024. Based on 193 observations after outlier removal (192 after the autocorrelation treatment), institutional ownership had no significant effect on earnings management. This result indicates that the proportion of institutional ownership does not guarantee effective monitoring. Free cash flow had a negative and significant effect on earnings management. Companies generating stronger internal cash tended to have lower discretionary accruals, so FCF may serve as an indicator that helps constrain opportunistic incentives. Profitability had a positive and significant effect, indicating that high earnings can create pressure to maintain reported performance. The three variables simultaneously had a significant effect, with an adjusted R^2 of 0.246.

For management, these results emphasize productive cash management, transparent disclosure of accounting policies, and stronger internal controls. For investors, earnings quality should be evaluated by comparing earnings, cash flow, margins, ownership structure, and accrual indicators. For future researchers, the model can be expanded to include leverage, company size, audit quality, financial distress, audit committees, managerial ownership, and measures of real earnings management. Taken together, the results distinguish a statistically insignificant ownership percentage from the significant cash flow and profitability associations. They support a more careful reading of earnings quality in which investors compare reported margins with operating cash generation and assess whether institutional shareholders actually participate in monitoring. The analysis also shows why the joint model should be treated as a useful screening framework: its adjusted R^2 of 0.246 leaves substantial variation to be explained by other financial and governance conditions.

5.2 Research Limitations

First, the sample includes only food and beverage companies with complete reports and institutional ownership data. The findings therefore describe a particular sector and period. Companies excluded because of incomplete reports may have risk and governance characteristics that differ from those of the sampled companies. Cross-sector, cross-country, or longer-panel studies can test whether the relationships identified are stable. Second, earnings management is proxied by discretionary accruals from the Modified Jones Model. This proxy is widely used and facilitates comparison across companies, but it is sensitive to performance, misspecification, and industry characteristics. Discretionary accrual values do not perfectly distinguish informative discretion from opportunistic actions. Further research should combine the Modified Jones Model, performance-matched accruals, and real earnings management measures such as abnormal production, abnormal cash flow, or abnormal discretionary expenses.

Third, secondary data do not allow researchers to observe directly the management decision-making process, the quality of audit committee meetings, or the reasons institutions engage in monitoring. Future studies can combine archival data with governance disclosures, audit quality scores, auditor tenure, compensation structures, and interviews or content analysis of annual reports. This approach would clarify why the institutional ownership percentage was insignificant in this model. Fourth, an adjusted R^2 of 0.246 indicates that most variation in earnings management remains outside the model. Variables such as leverage, company size, financial distress, sales growth, audit quality, audit committees, managerial ownership, ownership concentration, and tax pressure merit examination as predictors or moderators. Goodwood studies show that financial distress, internal control, tax planning, and report integrity can alter how financial conditions relate to reporting quality.

Fifth, the regression includes only institutional ownership, free cash flow, and net profit margin and omits control variables commonly associated with accrual-based earnings management, such as firm size, leverage, sales growth, operating cash flow, and board or audit committee characteristics. Omitted variable bias may therefore inflate or bias the coefficients of FCF and NPM, particularly because the two variables are positively correlated (Spearman rho = 0.578 among the 193 observations). The findings should be read as conditional associations rather than causal effects. Sixth, three features of the sample screening and estimation limit precision. The criterion used to flag the 19 outliers was not recorded and the results were not re-estimated with all 212 observations, so sensitivity to the exclusion and possible selection bias remain untested. The Cochrane–Orcutt lag was applied to the pooled series, losing one observation overall rather than the first observation of each company, and the autocorrelation coefficient was not reported. Finally, the dependent variable is signed DTAC, so the coefficients indicate direction rather than magnitude. Future studies should add the control variables listed above, report the outlier-detection statistic (z-scores, Mahalanobis distance, or Cook distance) with results estimated with and without the outliers, use panel estimators such as fixed or random effects or company-clustered standard errors, and estimate absolute discretionary accruals alongside signed values.

5.3 Suggestions and Directions for Future Research

The finding on institutional ownership suggests that companies should assess the effectiveness of institutional shareholders through monitoring activities rather than share percentages alone. Management can facilitate equal access to information, communicate significant accounting issues clearly, and follow up on audit committee recommendations. When institutional shareholders actively review accounting assumptions and cash flows, monitoring can function more effectively as a constraint on opportunistic discretion. The negative relationship between free cash flow and earnings management demonstrates the value of cash flow reporting that can be reconciled with earnings. Companies should explain the reasons for capital expenditures, changes in working capital, and the use of cash after operating needs have been met. This transparency helps investors distinguish cash-supported performance from earnings arising primarily from accrual estimates. Companies facing negative FCF should explain whether the condition reflects productive investment or liquidity problems.

The positive relationship between profitability and earnings management means that high-margin companies still require monitoring. Investors can examine margin consistency, receivables growth, changes in provision policies, and the conversion of earnings into operating cash flow. Audit committees should review assumptions most sensitive to earnings targets, including inventory estimates, asset impairment, and end-of-period revenue recognition. The combination of the three variables provides a practical initial screening framework. Institutional ownership indicates monitoring potential, FCF indicates cash support, and NPM indicates pressure to maintain performance. All three should be evaluated together and compared with auditor information, company characteristics, and industry conditions. This framework is a risk-screening tool and cannot be used to conclude that a particular company has violated rules without further examination. Finally, future research can test nonlinear and interaction models. Very low free cash flow may encourage earnings management because of financing pressure, whereas very high free cash flow may create agency costs. Similarly, moderate and extreme profitability may produce different incentives. Quantile, threshold, or dynamic panel regression can identify patterns not visible in a simple linear regression.

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Author Contributions
SW contributed to conceptualization, data collection, formal analysis, and manuscript drafting. NN was responsible for supervision, validation, and manuscript review and editing. DP contributed to methodological supervision and manuscript review, while ER was responsible for reviewing the accounting content and editing the manuscript. All authors reviewed and approved the final version of the manuscript.

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